

Tax News

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Pilot project to study shorter processing timeline for docketed protests

A taxpayer who receives a *Notice of Proposed Deficiency Assessment* may request an administrative review by the department by filing a “protest” (Revenue and Taxation Code Section 19041). The protest is assigned to a hearing officer in either the Audit Division or the Legal Department. Protests assigned to the Legal Department are designated as “docketed protests.”

FTB recently issued Notice 2006-05 (www.ftb.ca.gov, search term “FTB Notices”), “Pilot project for one-year timeline in processing docketed administrative protests.” Its purpose is to explore the possibility of achieving greater efficiency in processing these protests. The pilot project will allow certain taxpayers to request a one-year timeline for resolving their docketed protests.

Meeting the one-year processing period will be a goal for both the taxpayer and the hearing officer. The one-year period will begin on the date the protest is filed, and will conclude when a *Notice of Action* on the protest is issued (Revenue and Taxation Code Section 19045).

How to participate in the pilot program

Include a request for consideration to participate in the one-year processing pilot when you file your client’s initial protest. Protests filed before the date that Notice 2006-05 was published (October 27, 2006) are not eligible for this pilot.

Both FTB staff, and participating taxpayers will agree to follow guidelines that support meeting the goal of a one-year processing timeline. FTB maintains sole discretion in determining whether a taxpayer’s protest is included in the pilot program. The decision rests on several factors, including the number and complexity of issues raised in the protest, and resources available to the department in meeting the goal of completing the case within one year. We may also consider other factors in the decision.

More information on docketed protests

For details on the pilot, and your clients’ possible participation in the pilot program, see FTB Notice 2006-5. We have also released FTB Notice 2006-6, which provides more in-depth details on our internal procedures for processing docketed protests.

Visit our FTB Notices Webpage to see all current Notices, as well as our archive of notices issued from 1989 to the present.

FTB director of e-filing bureau appointed to IRS committee

Chris Beach, Director of the Filing Methods and Budget Bureau, has been appointed to the Internal Revenue Service Electronic Tax Administration Advisory Committee (ETAAC) as a state revenue agency representative. He will serve in this role for three years.

This committee is composed of members primarily from the private sector who have key roles in the expansion of IRS e-government programs. Members provide input to the IRS from the perspective of tax professionals, online commercial tax preparation companies, electronic banking companies, and state revenue agencies.

The committee is an organized public forum for discussion of electronic tax administration issues. It supports the goal that paperless filing should be the preferred, and most convenient method of filing tax and information returns.

Convened at the request of Congress, ETAAC submits an annual report directly to Congress. The report offers:

- Public and industry perceptions of IRS electronic tax administration activities.
- Constructive observations about current or proposed policies, programs and procedures.
- Suggested improvements.

We are proud that Mr. Beach has been honored by his selection to the Electronic Tax Administration Advisory Committee. He brings a wealth of electronic tax administration experience to the committee.

Notice of public hearing: Taxpayers' Bill of Rights

The annual Taxpayers' Bill of Rights hearing will be held Monday, December 4, 2006, at State Board of Equalization, 450 N Street, Room 121, Sacramento, CA 95814. For details, please read the notice found on our Website homepage www.ftb.ca.gov, under "Announcements."

Notice of public hearing: New apportionment methodology

A public hearing, as required by Section 11346.4 of the *Government Code*, will be held at 10:00 a. m., December 18, 2006, at 9646 Butterfield Way, California Town Center, Golden State Conference Rooms A and B, in Sacramento, California. This hearing will consider adoption of Section 25137-15 under Title 18 of the *California Code of Regulations*, authorized under Section 25137 of the California Revenue and Taxation Code, pertaining to the use of alternative apportionment methodologies. An employee of the Franchise Tax Board will conduct the hearing. After the meeting, a report will be made to the three-member Franchise Tax Board for its consideration.

Interested persons are invited to present comments, written or oral, on the proposed regulatory action. Persons who make oral comments at the hearing are requested, but not required, to also submit a written copy of their comments. Written comments will be accepted until 5:00 p.m., December 18, 2006.

Assigning business income using the three-factor apportionment formula

Taxpayers who have business activities within and outside of California are required to determine the amount of income properly attributed to California, by use of the Uniform Division of Income for Tax Purposes Act, Section 25120 et seq., California Revenue and Taxation Code. Under this act, business income is assigned to a state by applying a three-factor apportionment formula that separately compares a business' property, payroll, and sales within California, to those three values everywhere. The proposed regulation particularly considers the sales factor, i.e., differences between sales of tangible property, and sales of provided services, in assigning the location of sales. Specifically, the income-producing activity for the sale of mutual funds often occurs in a sole location, or very few locations, while having a market throughout the country. Customers of these companies are the fund shareholders, who receive the benefit of the services in locations scattered throughout the 50 states. Because the services are concentrated in one location, sales receipts are assigned to the single location, even though this is not indicative of the widespread market. The proposed regulation essentially adopts a similar shareholder location sales factor approach to that adopted in other states where mutual fund service providers are located.

The public notice, initial statement of reasons, and express terms of the regulation are available at the Franchise Tax Board's Website www.ftb.ca.gov (search term "legal documents") Interested parties can review an in-depth discussion of the proposed regulation, including legal authority and references, disclosures regarding the proposed regulatory action, contact information, and other valuable information.

Nonresident withholding requirements for S corporations

Revenue and Taxation Code Section 18662 requires S corporations to withhold tax on distributions of California source income paid to nonresident shareholders. These shareholders then typically must file California Form 540NR to report the income and pay any additional tax due, or claim a refund. Shareholders have two other options to fulfill California requirements:

- Request a waiver of the withholding requirement using Form 588, *Nonresident Withholding Waiver Request*.
- Elect to file a group nonresident return. See FTB Publication 1067, *Guidelines for Filing a Group Form 540NR*.

FTB will step-up enforcement of the S corporation withholding provision in 2007. We mailed letters in late 2005, to all known S corporations with nonresident S corporation shareholders, to inform them of their nonresident S corporation shareholders' filing requirements (see *Tax News* January/February 2006: *Information letters sent to S corporations with California income and nonresident shareholders*). We also supplied the S corporations with informational letters about the filing requirements to distribute to their nonresident shareholders.

As part of our ongoing effort to inform S corporations and their nonresident S corporation shareholders of their withholding and filing requirements, we:

- Mailed notices in November 2006, instructing the S corporations with nonresident S corporation shareholders to begin withholding starting in January 2007.
- Will conduct additional education and outreach presentations to ensure S corporations are aware of withholding and filing requirements.
- Will send notification of withholding requirements to new S corporations formed after December 16, 2005.

The forms and publications referred to above, as well as filing information, are available on our Website at www.ftb.ca.gov, or by calling FTB's Taxpayer Services Center at (800) 852-5711 (toll-free) or (916) 845-6500 (not toll-free).

FTB's Withholding Services and Compliance Section offers seminars to help our customers understand California Nonresident Withholding requirements for S Corporations. To schedule a seminar, contact us at WSCS.Seminars@ftb.ca.gov.

FTB, focus group explore implications of SB 1827

FTB is already gearing up for a new law that will take effect for tax year 2007, SB 1827 (Migden, D-San Francisco).

SB 1827 requires registered domestic partners (RDP) to use the same state tax filing status as married couples. In 2008, they must choose to file their state tax return as married filing jointly, or married filing separately, using the same standards that apply to married persons under federal law. Under current state and federal law, they use the single or head of household filing status. The new state law has no impact on the federal law.

After Governor Schwarzenegger signed the bill into law in September, FTB quickly established an implementation team to review the various processes, forms, and systems changes needed before January 1, 2008.

We convened a focus group of interested parties, consisting of tax practitioners, the State Bar of California, and domestic partner groups. This group met November 30, to discuss matters related to the legislation for affected taxpayers and tax professionals. We plan to have information from this meeting posted on our Website by January 1, 2007. Some of the issues discussed include:

- How to compute adjusted gross income for state purposes.
- Rules on capital gains from the sale of a home.

Registered domestic partnerships include same-sex partnerships, and heterosexual couples in which one or both partners are age 62 or older. According to the Secretary of State, there were 38,155 RDPs in California as of April 2006. The estimate for the total number of RDPs in California by December 2007 is 40,950.

Taxpayers and interested parties can submit questions on this matter via FTB's Website at www.ftb.ca.gov, or by emailing RDP@ftb.ca.gov.

New forms Webpages

We are pleased to announce two new forms pages within our main Website www.ftb.ca.gov. We hope you'll visit them soon, and often.

California's voluntary contribution funds Website

Since 1982, taxpayers have been able to quickly and easily make charitable contributions to a variety of organizations on their tax returns, simply by entering a contribution amount on the 540 2EZ, 540A, 540, 540NR (long or short form), and the 541 Schedule C.

Perhaps your clients have designated contributions to one or more of the voluntary contribution funds (VCFs), or have had questions about the organizations receiving the charitable contributions. FTB's new *Voluntary contribution fund* Website offers information on fund descriptions, contribution totals, fund contact information, and much more.

Over the years, we have heard from many taxpayers, who wondered:

- Is there a minimum amount I must contribute?
- How many funds can I contribute to?
- What happens if I change my mind after I check the box and send in my return?
- Where can I get more information about the various funds?

Check the VCF Webpage (www.ftb.ca.gov search term "VCF") for answers to these, and many other VCF questions. In the future, we plan to add an email subscription to this site. Subscribers will receive email updates about new, or expiring VCFs, and other related information.

Draft tax forms Website – your chance to suggest changes to FTB tax forms

Have you ever thought that you could help California taxpayers if you just had a forum for your ideas on improving our tax forms? If your answer is yes – have we got a Webpage for you. It's part of our FTB Website www.ftb.ca.gov, and you can find it by selecting the *Forms* tab at the top of the FTB homepage, and selecting the link to *Draft tax forms* on the left-hand side of the page. Once there, you'll see a list of FTB forms, each linking to a specific booklet, publication, or tax form. Click on the link to review the current **draft** version of the form, or select the *Comments* link, which will take you to the "comments" box where you can enter your suggested revisions, or comments. Don't forget to indicate which form or publication you're commenting on, and the year. When you're satisfied with your comment, click *Send Suggestion*, and you're done.

Anticipating your frequently asked questions**When will the draft versions be available?**

Draft versions will be available from July to mid-December. In December, the official forms are loaded to the Internet and all draft versions are removed from the Webpage.

How can I tell a draft form from a final form?

Draft forms have the word *DRAFT* printed across the face of the page.

Can I file a draft version of a form?

No, only official tax forms can be filed with FTB.

Are all FTB tax forms available as draft forms?

All forms may not be available in draft version. Forms are loaded to the Website as they near the final stages of the review process, and some forms may load directly to the official forms Webpage.

How is this Website different from the Computerized Tax Processor (CTP) Website?

The CTP Website is a restricted Webpage for computerized tax processors, tax software developers, publishers, printers, and other tax professionals that create electronic versions of FTB tax forms. The draft tax forms Website is for tax practitioners and taxpayers to view and comment on tax forms. To gain access to the CTP restricted Website you must complete [FTB 1096, Agreement to Comply with FTB Pub. 1098](#), and submit it to FTB for review and approval.

How will FTB address my comment or suggestion?

Although we may not be able to respond to every comment, we value your feedback and will consider all comments as we revise our tax products.

Check on changes to current tax forms

Keeping up with changes to tax forms can really save you time during the filing season crunch. It will also save time once we receive your clients' returns - using old or obsolete tax forms can really slow down processing. Make sure you're up-to-the-minute on any tax forms changes. Check our *Changes to Forms* Webpage (www.ftb.ca.gov search term "changes to tax forms") before you begin preparing returns.

How to streamline withholding order processing

We were recently made aware of a problem that some companies have when they process our *Earnings Withholding Orders for Tax* (EWOTs), and *Orders to Withhold* (OTWs). The mailrooms of some companies process all mail from tax agencies by routing it to the company's tax department, including EWOTs and OTWs. Sending withholding orders to the tax department can delay processing, if the company actually processes them in the payroll department, or another business unit. When EWOTs or OTWs are incorrectly routed to the company's tax department, the delay can cause the company to process them late, or to rush to get them processed on time.

The fix for this problem is simple – if the company you represent wants to have EWOTs and OTWs mailed to a different address, contact us. Call us at (800) 852-5711, or at the phone number listed on the EWOT or OTW, to make an address change. For example, you can add "Attn: Payroll Department" to your company's mail address, or provide a different address.

Criminal Corner

We are committed to closing California's \$6.5 billion tax gap, defined as the difference between tax that is owed and tax that is paid. Our special agents work cooperatively with law enforcement agencies throughout California to uncover illegal behaviors that contribute to the tax gap. These include underreporting income, overstating deductions, failing to file returns, failing to pay taxes due, and making illegal cash payments to employees. Tax fraud is not a victimless crime. You can report suspected tax fraud by calling FTB at (800) 540-3453.

The principal mission of our criminal investigation program is to identify, investigate, and effect prosecution of tax evasion, fraud, and employee misconduct; encourage compliance with the California income tax laws, and maintain the public trust through publicity. Special investigation agents have Peace Officer law enforcement status. In carrying out the criminal investigation process they conduct interviews, trace money, execute search warrants and felony arrest warrants, and testify in court trials.

As of October 31, 2006, the criminal program has successfully prosecuted 54 individuals, with the courts awarding \$3,073,244 in restitution.

Cases prosecuted last month are described below.

Parkers stand trial on pot charges

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Mendocino Superior Court Judge David Nelson found Thursday there is sufficient evidence to hold Memo and Mark Parker for trial on some of the charges filed against them in connection with a search warrant served on two houses on Gardens Avenue. Memo Parker will stand trial on charges of possession of marijuana for sale, cultivation of marijuana for sale, management of a location for the production of a controlled substance, possession of concentrated cannabis and one count of failure to file a tax return.

His brother, Mark Parker, will stand trial on charges of possession of marijuana for sale, cultivation of marijuana for sale, and management of a location for the production of a controlled substance.

"The amount of marijuana here seems to be much higher than needed for medical use," Nelson said.

During the service of a search warrant October 16, law enforcement officers seized more than 400 marijuana plants and 170 pounds of processed marijuana from houses owned by Memo Parker at 130 and 106 Gardens Avenue.

The brothers' attorneys, Edie Lerman representing Mark Parker, and David Nick representing Memo Parker, both contend the brothers were growing marijuana for medical use.

Team commander Rusty Noe testified that by his estimation, the combined weight of processed and growing marijuana was more than necessary for medical use. "What we discovered was excessive," Noe said.

Nick questioned Noe's estimation of how much marijuana a given plant would have produced. Noe testified that he did not look at every single plant and that he did not harvest any of the plants to see if his estimations were correct.

Nick also entered into evidence a document signed by Dr. Jeffrey Y. Hergenrather that said Memo Parker's medical condition allowed him the right to possess more marijuana than is permissible under state law.

Lerman said Mark Parker had a similar document but did not produce it for the court. In Mendocino County, patients are allowed to possess roughly two pounds of marijuana for medical purposes, and Mendocino County allows patients to grow a 10-by-10 foot canopy of marijuana for medical purposes.

Noe also testified that 32 pounds of processed marijuana in bags was seized from one of the houses on Gardens Avenue. Noe said the marijuana had been separated in bags of differing weights ranging from two pounds to one ounce.

Noe testified he did not observe Memo or Mark Parker sell marijuana to anyone and did not investigate who they might have sold marijuana to.

As evidence of failure to file tax returns, Deputy District Attorney Brian Newman presented copies of documents from the state Franchise Tax Board, which showed no record of a tax return filed by Memo Parker between 2001 and 2005.

Nick said the court could not infer from that evidence that Memo Parker had fraudulently failed to file a tax return when it is possible that he simply did not make any money during those years.

Newman cited the \$22,000 seized from Memo Parker's bank account and his ownership of two houses and a 1997 BMW sedan and a 1999 GMC as evidence of an income. Newman also cited evidence gained from an investigation of utility bills for 130 Gardens Avenue as evidence of a significant and unreported income.

Ukiah Police Sgt. Justin Wyatt testified that, between August 2004 and September 2006, those monthly bills were regularly in excess of \$1,000. Nick questioned the accuracy of those documents.

Nelson said the court could infer an income for 2005 and hold Memo Parker to answer on charges for that year, but that there was not sufficient evidence to infer the same for previous years.

Memo and Mark Parker are scheduled to be arraigned on the listed charges at 10 a.m., November 9.

The buzz on big business

Audit by Sampling

If FTB recently reviewed your or your client's business state tax return, it may have been done a little differently. We may have asked your consent for our use of a sampling method to verify an expense, credit, or other return position. Verifying return positions can be a lengthy, time-consuming process, and unnecessary in some situations. Sampling is one of many tools available for efficiently addressing an audit issue, while minimizing intrusion in a taxpayer's business.

We have recently adopted new sampling procedures, which include a sampling agreement, agreed to by the auditor and the taxpayer. The procedures are applied as appropriate to each audit situation, with the objective that FTB and the taxpayer will agree on how the sampling will be performed, and how the results will be used to determine any proposed adjustments.

Before we use sampling to audit an issue, we will present the taxpayer with a written sampling agreement. In addition to documenting the sampling process, the sampling agreement:

- Describes what is being sampled, and the sample size.
- Explains what constitutes an error, and how the error rate will be applied to determine the proposed adjustment.
- Ensures that you or your client understand and agree with the methodology being used.
- Gives you or your client the opportunity to provide input into the sampling process.

As necessary, other information can be substituted or added to the agreement based on the circumstances of the specific audit.

By signing the sampling agreement before any testing is performed, we reach agreement on the method before we expend any effort on the testing process. You or your business clients are able to evaluate the approach and provide feedback. The sampling agreement ensures we limit resources to the extent possible, both yours and ours, to resolve the audit issue most efficiently.

Signing the agreement reserves your right to disagree with specific disallowed items, while confirming your acceptance of the sampling methodology's stated terms.

Corrections to November Tax News

Incorrect information was included in the article "Legislative wrap-up 2006" in November's *Tax News*. The third bullet in the description for AB 2341 (Villines Stats. 2006, Ch. 773) incorrectly states:

- "The entity files documents for dissolution, surrender, or cancellation within 12 months of the due date of the final return, *without regard to extension*."

The bullet should state:

- "The entity files documents for dissolution, surrender, or cancellation within 12 months of the due date of the final return."

The article "California's new filing requirements for registered domestic partners" originally contained the statement "These new filing requirements apply to taxable years beginning on or after January 1, 2007, *for returns filed on or after April 15, 2008*."

This statement has been corrected and now reads "These new filing requirements apply to taxable years beginning on or after January 1, 2007."

We regret any inconvenience this may have caused.